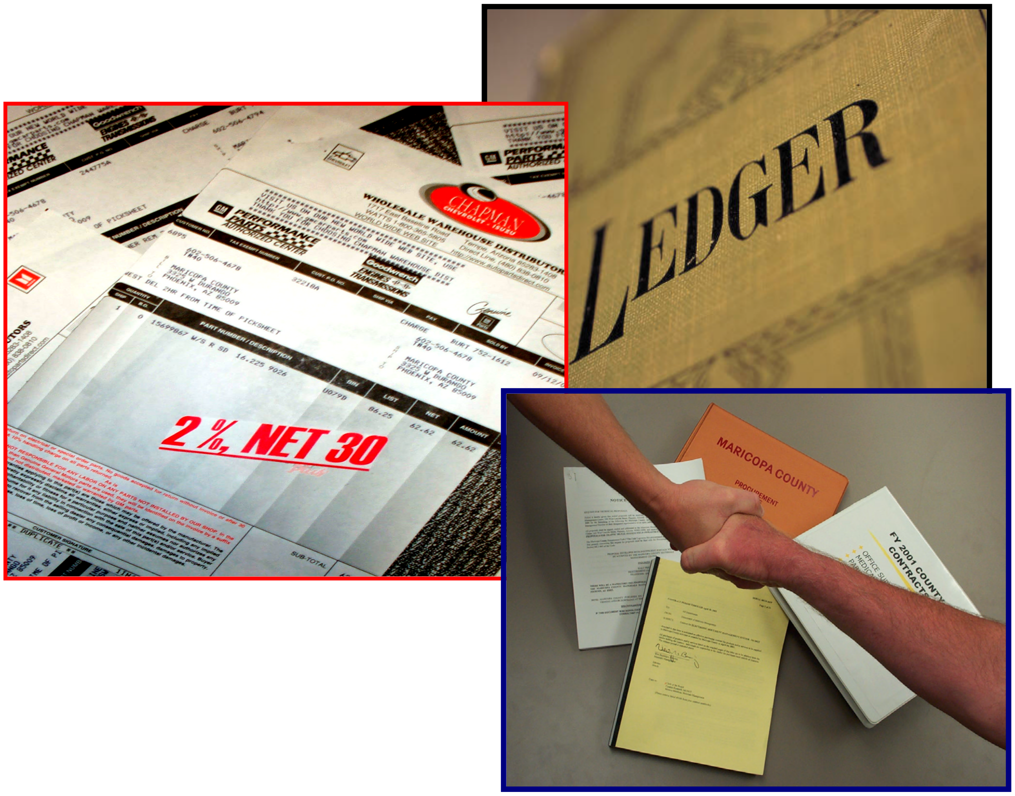
MARICOPA
1871
ARIZONA
COUNTY

# Internal Audit Report

## Vendor Payment Processing
June 2002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LEDGER
MARICOPA COUNTY

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Maricopa County Internal Audit Department *"Do the right things right!"*

**Internal Audit Department**

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MARICOPA COUNTY
ARIZONA

June 30, 2002

Don Stapley, Chairman, Board of Supervisors
Fulton Brock, Supervisor, District I
Andrew Kunasek, Supervisor, District III
Max W. Wilson, Supervisor, District IV
Mary Rose Wilcox, Supervisor, District V

We have completed our FY 2001-2002 review of Countywide Expenditures. The audit was performed in accordance with the annual audit plan that was approved by the Board of Supervisors. The review focused on the vendor payment process.

The highlights of this report include the following:

- The County could realize an estimated $374,000 annually through enhancements to the vendor payment process.
- County departments could improve controls with additional training in vendor payment processing.
- No exceptions were found in testing for high-risk vendor payments or inappropriate vendors.

Attached are the report summary, detailed findings, recommendations, and management responses. We have reviewed this information with the Department of Finance and Materials Management and appreciate the excellent cooperation of all County employees involved. If you have questions, or wish to discuss items presented in this report, please contact Joe Seratte at 506-6092.

Sincerely,

Ross L. Tate

Ross L. Tate
County Auditor

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# Executive Summary

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Internal Audit used Computer-Assisted Audit Techniques (CAATs) to analyze over 264,000 vendor payments from FY 2001and FY 2002. We isolated high-risk payments and tested a sample of high-dollar or unusual transactions for errors. No exceptions were detected in our test work (i.e., duplicate payments, non-contract payments, or payments made in error).

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During our review of vendor payment processing we found areas where additional employee training could improve departments' ability to more accurately process vendor payments. DOF and Materials Management should work with Internal Audit to design and deliver the necessary training.

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County vendors should be legitimate businesses that are free of conflicts-of-interest or inappropriate relationships with County employees. We used CAATs to analyze over 37,000 vendors and 11,000 employees. Our testwork identified no exceptions, conflicts-of-interest, or inappropriate employee/vendor relationships.

# Introduction

## Background

The approved audit plan for FY 2002 directed Internal Audit to review an element of the County's expenditure cycle. The County's FY 2001 Comprehensive Annual Financial Report (CAFR) shows combined governmental fund expenditures to be more than $1.2 billion. The majority of these expenditures are personnel expenses disbursed through the payroll system in the form of employee compensation. Internal Audit performed a review of the payroll system in FY 2000.

Non-payroll expenditures account for over $500 million annually. The expenditures are made through many different departments throughout the County. However, all disbursements pass through the Accounts Payable function of the Department of Finance (DOF) each year.

During this initial audit of the County's expenditure cycle, we decided to review the vendor payment process for the County. The review considered the entire payment cycle including Materials Management, DOF, and all user departments.

## Computer Aided Audit Techniques

Computer Assisted Audit Techniques (CAATs) enable Internal Audit to download and analyze large numbers of transactions in our audit tests. We used Audit Command Language (ACL®) software to analyze approximately 350,000 transactions encompassing FY 2001 through February of FY 2002.

We focused on high-risk vendor payments to test for potential overpayments or other payment errors. Using ACL, we performed a number of targeted tests on segments of the vendor payment population most likely to produce errors.

Although the focus of the audit was a review of transactions, we also developed several recommendations for improving the vendor payment process in administrative functions and County departments.

## Scope and Methodology

The objectives of this audit were to:

- Isolate and test high-risk vendor payments for potential overpayments.
- Ensure County vendors' relationships are authorized, appropriate, and free of conflicts-of-interest.
- Identify potential improvements in the vendor payment process.

This audit was performed in accordance with Government Auditing Standards.

# Issue 1 Process Cost Savings

**Summary**

The County could realize an estimated $374,000 annually by scheduling vendor payments, isolating tax exempt transactions, and using the County purchase card. DOF and Materials Management should work together with County departments to pay invoices at the due date, structure contracts and invoices to avoid sales tax, and use purchase cards to process small-dollar items.

Our review identified three areas of the vendor payment process in which the County could enhance revenues and reduce costs. These areas are summarized in the table below.

## SAVINGS SUMMARY TABLE

| ACTION | EFFECT | SAVINGS |
|---|---|---|
| Schedule Vendor Payments | Increase Interest Income | $ 286,000 |
| Separate Non-Taxable Items | Reduce Sales Tax Expense | $ 85,000 |
| Utilize Purchase card | Reduce Processing Costs | $ 3,000 |
| TOTAL | | $ 374,000 |

### Scheduling Vendor Payments

The U.S. Department of Treasury, Finance Management Services Section, recommends that an agency's systems be designed to schedule the issuing of payments as close as possible to, but no later than, the due date specified in the contract or the invoice.

Currently, disbursements not eligible for early payment discounts are processed by DOF when received. Scheduling payments and allowing County funds to earn interest with the Treasurer for a few additional days provides a very small incremental return for each payment. However, implementing this practice for a system whose vendor payments are measured in hundreds of millions of dollars annually could generate an additional $286,000 of interest revenue.

## Sales Tax Savings

Although a government entity, the County is not exempt from sales tax. One audit objective was to provide assurance to management that the County complies with tax requirements, without paying more sales tax than necessary.

Overall, DOF controls over the application and payment of sales tax are effective. Our testing found that the County pays sales tax when appropriate, and does not pay tax on exempt items (e.g., alternative fuel vehicles, pharmaceuticals, etc.).

**Software service and maintenance charges are non-taxable items.**

However, we determined that the County could reduce sales tax expense in the area of software maintenance and support. Software maintenance and support is a service and is therefore not taxable. But because service charges are bundled with software upgrades, which are taxable, the Arizona Department of Revenue considers the entire purchase to be taxable. Based on the County's software maintenance and support expenditure level, we estimate that as much as $85,000 could be saved per year if we structure software contracts and invoices to our advantage.

## Reducing Processing Costs

A recent benchmarking study of government Accounts Payable functions showed that the average cost to process an invoice was $7.92. DOF reports the County's cost to be $4.62. In our review of payable transactions, we noted cases in which vendor warrants were processed for as little as $0.70. Credit Data Southwest and Federal Express are vendors for whom a significant number of small-dollar warrants were processed. By using warrants, the County spent $3,129 to process $9,210 in payments to Credit Data Southwest, which amounts to 34 percent of the total expense.

The County Purchase Card (P-card) program was established to make small-dollar purchases more efficient. Using a County P-card to pay for these types of transactions would save the County significant processing dollars.

**Recommendation**

DOF should:

**A.** Determine the feasibility of scheduling payment dates on the Advantage system.

Materials Management should:

**B.** Structure County RFP's and contracts for software support to segregate taxable and non-taxable components.

Affected Departments should secure training to ensure:

**C.** Software support invoices breakdown charges between taxable and non-taxable components.

**D.** County P-Cards are consistently used for low dollar purchases.

# Issue 2 High-Risk Vendor Payments

**Summary**

Internal Audit used Computer-Assisted Audit Techniques (CAATs) to analyze over 264,000 vendor payments from FY 2001and FY 2002. We isolated high-risk disbursements and tested a sample of high-dollar or unusual transactions for errors. No exceptions were detected in our test work (i.e., duplicate payments, non-contract payments, or payments made in error).

Accounts Payable audits are performed to provide assurances to management that payments made to vendors conform to contract, are paid only once, and are made only for goods and services received.

Computer-Assisted Audit Techniques (CAATs) utilize auditing software and allows internal auditors to review large amounts of data during audit testwork. We used Audit Command Language (ACL®) software to download and analyze approximately 350,000 vendor payments from fiscal years 2001 and 2002. We then executed a number of targeted tests to detect unusual or high-risk payments. We isolated high-risk transactions such as large dollar invoices or unusual payment patterns and tested a sample of these transactions for duplicate or erroneous payments.

**Benchmarking Study**

In a recent government benchmarking study, 95 per cent of government payables departments report that duplicate payments occur less than 0.5 per cent of the time. This infrequent occurrence makes duplicate payments hard to detect. However, in an environment that processes millions of dollars in vendor payments each year, the dollar value of a fractional error can be significant.

**No Payment Errors Identified**

We used ACL software to execute several targeted tests designed to identify transactions more likely to include payment errors. For example, one audit test grouped payments that were made to the same vendor, for the same amount, on the same day. All potential duplicate payments tested were traced to supporting documentation, and were found to be separate, valid transactions.

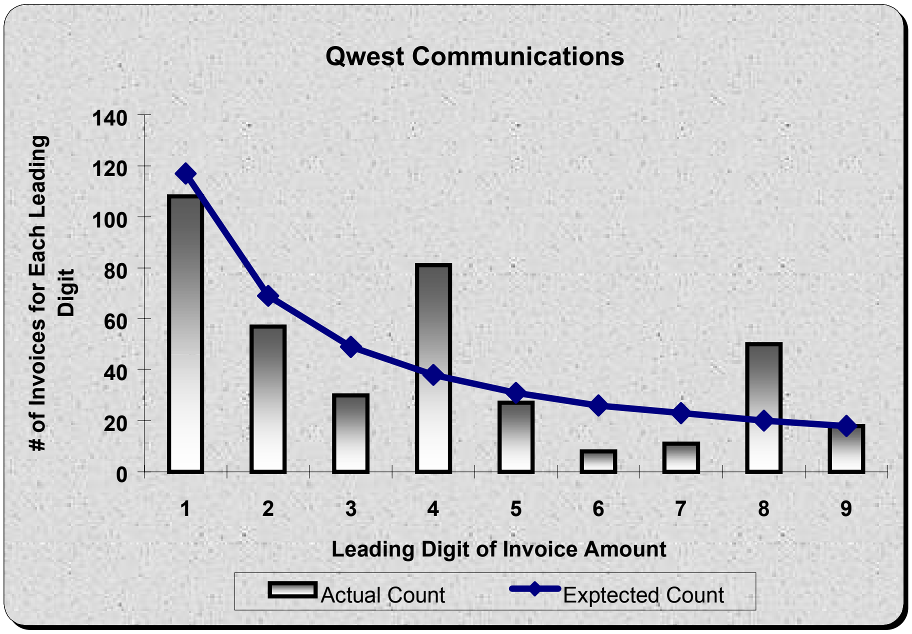
**One set of potential duplicate payments turned out to be repetitive copier maintenance payments.**

Another CAATs used to test vendor payments is called digital analysis. Digital analysis capitalizes on the principle of Benford's Law. Benford's Law says there is a pattern to the dollar-values in a large, random population such as vendor payments. The pattern is consistent and is shown as the line in the graph below.

We selected 34 of the County's largest vendors for digital analysis testing. We downloaded all transactions for these vendors and, using CAATs, matched the pattern of disbursements to the pattern Benford's Law predicts. Vendors whose payment patterns did not correlate to expectations were extracted for further review.

## Analysis Results

Several vendors' payment patterns contained noticeable "spikes" in the data. However, detailed audit testing of these vendors accounted for the spikes and showed all disbursements represented valid transactions. We found no exceptions in digital analysis testing.



**The spikes on the numbers "4" and "8"were caused by similar lease payments with Qwest.**

## Recommendation

None, for information purposes only.

# Issue 3 Department Processing

### Summary

During our review of the vendor payment process we found areas where additional employee training could improve departments' ability to more accurately process payables. DOF and Materials Management should work with Internal Audit to design and deliver the necessary training.

Materials Management and DOF play a large part, respectively, to initiate and complete the vendor payment process. Between negotiating a contract and paying an invoice, we found three factors that influence the accuracy and efficiency of the County's vendor payments:

- The County's vendor payment process is decentralized, placing the majority of responsibility with County departments.
- The County Advantage system is presently not a user-friendly system and using it effectively requires significant training.
- Employee turnover increases the need for recurring training cycles.

### Control Weaknesses

Our review identified common departmental practices that increase the risk of errors in the vendor payment process. We found that departments:

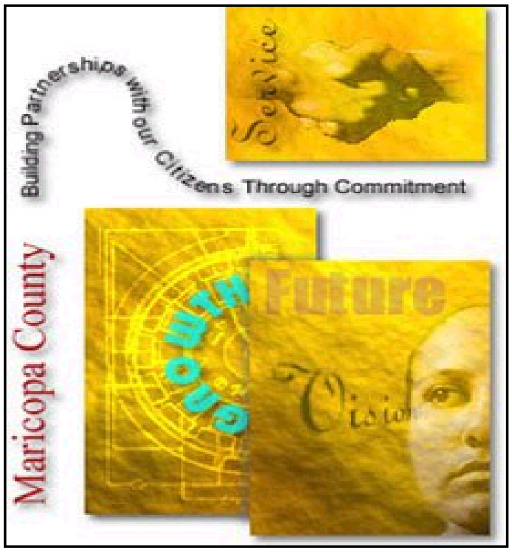
- Do not always have ready access to contract pricing and terms.
- Do not regularly reconcile department records to vendor balances.
- Prepare payments from non-conforming documents such as incomplete invoices, copies of invoices, or statements.
- Correct billings by manually adjusting invoices.

Departments could improve the payables process by:

- Ensuring they have ready access to contractual pricing and terms either on-line or through a hard copy of the contract.
- Requesting a vendor statement, and reconciling department records to vendor balances.
- Ensuring that vendor invoices are sufficiently detailed to identify accurate terms and pricing.
- Requesting a new invoice when charges are incorrect, rather than manually adjusting invoices.

### Departmental Training

County departments currently have training opportunities related to the procurement process. Materials Management provides training for the Certified Agency Procurement Aide (CAPA) designation. Internal Audit conducts a Control Self Assessment workshop in Contract Administration. In addition, DOF conducts a training class in basic invoice processing. Discussions with DOF indicate that County departments could benefit from more comprehensive training targeted at vendor payment processing and encompassing the entire vendor payment cycle.


Building Partnerships with our Citizens Through Commitment
Service
Maricopa County
GROWTH
Future
Vision

**Some contracts can be viewed through the EBC Homepage.**

### Recommendation

DOF and Materials Management should:

**A.** Participate in a process mapping exercise for the payables cycle.

DOF should consider:

**B.** Increasing the number of training sessions performed for operating department personnel.

Internal Audit and DOF should:

**C.** Prepare and facilitate a CSA workshop on the payables cycle open to all departmental purchasers.

# Issue 4 Vendor Validation

**Summary**

County vendors should be legitimate businesses that are free of conflicts-of-interest or inappropriate relationships with County employees. We used CAATs to analyze over 37,000 vendors and 11,000 employees. Our testwork identified no exceptions, conflicts-of-interest, or inappropriate employee/vendor relationships.

One audit objective in reviewing vendor payment processing was to provide assurance to management concerning the County's contracted vendors. We wanted to verify that vendors represent legitimate, appropriate businesses and that vendors are free of any conflict-of-interest relationships with County employees.

**Targeted Vendor Testing**

We used CAATs to download and analyze the Advantage system vendor file, which contains over 37,000 registered County vendors. We targeted vendors using a P.O. Box for a business address and an individual's Social Security Number (SSN) for a tax ID as potentially high-risk. We identified 1,450 County vendors that fit these criteria. We reviewed invoices for the entire sample, determining that many of them were well-known businesses. No conflicts-of-interest or inappropriate relationships were found in our testing.

**Fictitious vendors can use mail drops as a business address.**

**Employee Vendors**

County policy and practice does not preclude active employees from also having a vendor relationship with the County. Some employees, such as court reporters, have necessary reasons for receiving both salary and vendor compensation from the County. However, the County ethics policy does prohibit conflicts-of-interest. Some employee/vendor relationships are considered to be inappropriate.

We used CAATs to join the employee payroll and vendor masterfiles, containing approximately 11,000 and 37,000 records, respectively. We searched for matches on three fields – tax ID, address, and telephone number. After eliminating known employee/vendor situations (e.g., court reporters), we identified 129 other employees registered as County vendors.

**No Inappropriate Relationships**

We manually reviewed the 129 employee/vendors and found that most had little or no activity as a vendor. For the remainder, we reviewed job duties, vendor billings, and employee time sheets to determine the range and nature of vendor services, in relation to responsibilities at the County. We found no inappropriate relationships or conflicts-of-interest.

**Recommendation**

None. For informational purposes only.